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The Great Depression – Causes and Responses

Causes of the Great Depression

During the 1920s, the United States seemed to be prospering as never before. However, the "Roaring Twenties" hid serious problems with the U.S. economy. These problems would eventually lead to the Great Depression, the worst economic disaster in the nation's history. During the Great Depression, businesses and banks failed and millions were left homeless and without jobs.

Historians have identified several key causes of the Great Depression. The first was tariffs. Tariffs are special taxes that the government charges on imported goods. The purpose of tariffs is to protect U.S. industries by encouraging people to buy goods made in the U.S. However, other nations often respond to tariffs by refusing to buy U.S. produced goods. The result was huge surpluses of manufactured goods that businesses could not sell.

The second factor was the crisis in farming. For decades prior to the Great Depression, U.S. farmers had borrowed money to buy land, seed, and new farming equipment. Farmers hoped to be able to pay off their debts with increased production and rising crop prices. However, with foreign markets closed off after World War I, farmers wound up with huge surpluses of crops they could not sell. This overproduction led to falling farm prices. Farmers made less money and could not afford to pay off their increased debt.

A third cause of the Great Depression was excessive consumer debt. Throughout the 1920s, the Federal Reserve had kept interest rates low. This encouraged people to borrow money to buy expensive new items like cars and radios or to buy them on credit. This meant that many American consumers were deeply in debt and often owed more money than they made.

A fourth factor leading to the economic collapse was unequal distribution of income. Even though business profits increased during the 1920s, the wages earned by American workers failed to rise. This meant that many Americans could not afford to buy the finished goods that factories were producing, even using easy credit. The result of this was a falling demand for consumer goods. Once again, American businesses were left with huge surpluses of goods they could not sell because their workers did not make enough to buy them.

The final problem with the economy was the stock market. In the stock market, people could invest in companies by buying stock in that company. If the company was successful, then the people who had invested and bought stock in the company also made money. However, many investors were buying stock on credit. They would only pay a portion of the stock's price and then borrow the rest. This would work well as long as the company continued to be successful and make a profit. If the businesses failed, however, people would be left with stocks that were worthless and huge debts to pay off. This is exactly what happened with the Stock Market Crash of 1929.

President Hoover Responds

The president at the beginning of the Great Depression was Herbert Hoover. At first, Hoover chose to do nothing. He thought that the economy would eventually fix itself. However, as the Depression worsened, more business failed and more people were left out of work. It was clear that this was a bigger problem than America had faced in the past.

Next, Hoover tried to convince business to invest more money in an attempt to "jump start" the economy. Hoover believed that if he could help the struggling businesses, the wealth would eventually "trickle down" to the needy workers and unemployed families. However, the programs* that Hoover designed were voluntary and most businesses refused to go along with them. Having lost so much money in the stock market crash, businessmen did not want to risk more by re-investing. * Reconstruction Finance Corporation

Hoover next tried to balance the budget by cutting government spending and raising taxes. This only made problems for the poor worse. With reduced government spending, there were fewer government programs to assist the poor and needy. Higher taxes meant that those who still had a job were bringing home less money. If the consumers had less money to spend, then businesses would continue to fail as their profits dropped.

Congress next tried to fix the problem. Their solution was to increase the tariff. The new tariff was called the Smoot-Hawley Act and raised tariffs on over 20,000 imported goods. The goal of the tariff was to help struggling U.S. businesses by protecting them from foreign competition. However, after the passage of the tariff, other countries imposed their own tariffs on U.S. goods. The result was that exports and demand for U.S. produced goods dropped. The tariff actually hurt U.S. businesses more than it helped them.

The Federal Reserve also tried to respond to the Great Depression. The job of the Federal Reserve is to regulate the U.S. banking industry. Banks had also invested in the stock market in the 1920s. As a result of the crash, many banks were failing and the people who had put money into them were losing their life's savings. The Federal Reserve tried to loan money to banks in order to keep them open. The Federal Reserve also lowered interest rates in an attempt to increase the money supply and encourage more investing. However, these actions came too late and did not do enough to keep banks from failing.

President Roosevelt Responds

As the depression worsened, President Hoover failed to win re-election in 1932. The new president, Franklin D. Roosevelt promised the American people a "New Deal". In response to the Great Depression, Roosevelt would focus on the "3 R's": relief, recovery, and reform.

"Relief" meant that the government would try to help the people in most desperate need. Roosevelt created government jobs programs in an attempt to decrease unemployment. The government also provided low-interest loans to homeowners so they could continue to pay their mortgages. Roosevelt's New Deal also provided direct relief to people through state and federal programs to help the unemployed, the aged, and the ill.

"Recovery" meant trying to return the economy to pre-Depression levels. Since overproduction had been a big cause of the Great Depression, Roosevelt tried to lower production to meet demand. The New Deal assisted farmers by helping to raise crop prices. It did this by paying farmers to destroy crops and leave land unplanted. With less food produced, prices would rise and farmers could begin to make enough money to get out of debt. Roosevelt also tried to regulate industry with rules for production, fair competition, and worker pay and conditions. Since low worker wages had been one of the contributing factors to the Great Depression, workers were allowed to unionize and demand regular increases in pay. Finally, Roosevelt tried to help along economic recovery by increasing the amount of money in the economy. He did this by putting large amounts of government money into huge new jobs programs and public building projects. As more people were put back to work, they would have more money to spend. This in turn would help businesses to recover.

"Reform" meant trying to reform America's finances so that nothing like the Great Depression could ever happen again. Roosevelt first tried to restore faith in American banks by temporarily closing them. The banks were then inspected by the government and only allowed to reopen when they were found to be in good order. Next, Roosevelt helped win passage of the Federal Reserve Act. This new law crated the Federal Deposit Insurance Corporation. The FDIC would use government money to insure or protect the money that people deposited in banks. Even if the bank failed, people would still be guaranteed of getting their money back. Finally, Roosevelt supported government regulation of the stock market. The practice of buying stock on credit, or "buying on margin", was made illegal. Government inspectors also made sure that companies did not provide false information about their stock or financial gains to insiders with special information.

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Causes of the Great Depression

Directions: From the reading, identify the 5 main causes of the Great Depression. Then briefly explain how each helped to weaken the U.S. economy.

Cause	How it Weakened the Economy

President Hoover Responds

Directions: From the reading, identify how each of the following people or groups tried to respond to the Great Depression. Then explain why the response was unsuccessful.

Group	Response	Why Response was Unsuccessful
Hoover		
Congress		
Federal Reserve		